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IN THE

Supreme Court of the United States

OCTOBER TERM 1961

No. [redacted] 153

MEMPHIS TRANSIT COMPANY,
Petitioner,

v.

THE UNITED STATES,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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INDEX

	PAGE
Opinion Below	1
Jurisdiction	1
Questions Presented	2
Statutes Involved	3
Statement	3
Reasons for Granting the Writ	8
Conclusion	18
Appendices:	
A—Opinion and Judgment of the United States Court of Claims in Petitioner's Case	1a
B—Stipulation of Facts filed with the United States Court of Claims in Petitioner's Case	1b
C—Statutes and Regulations Involved	1c

CITATIONS

Cases:

Drybrough, F. W. et al. v. *Commissioner of Internal Revenue*, 238 F. 2d 735 (6th Cir. 1956)	15
Lewyt Corporation v. *Commissioner of Internal Revenue*, 349 U. S. 237 (1955)	16, 17, 18
Memphis Transit Company v. *United States*, 297 F. 2d 542 (Ct. Clms. 1961)	1

PAGE

National Labor Relations Board v. *Waterman Steamship Corporation*, 309 U. S. 206 (1940) 10

Pacific Affiliate, Inc. v. *Commissioner of Internal Revenue*, 224 F. 2d 578 (9th Cir. 1955) cert. den. 350 U. S. 976 ..... 15, 16, 17

Statutes:

Internal Revenue Code of 1939:

Section 23(f), Act of February 10, 1939, 53 Stat. 1, 13 3

Section 23(l), Act of February 10, 1939, 53 Stat. 1, 14, as amended, 26 U.S.C. (Supp. II, 1940 Ed.) 3

Section 113(a), Act of February 10, 1939, 53 Stat. 1, 40, as amended, 26 U.S.C. (Supps. I-V, 1940, Ed.) 3

Section 718(a), 2d Revenue Act of October 8, 1940, 54 Stat. 974, as amended, 26 U.S.C. (Supp. II, 1940 Ed.) 3

Title 28, United States Code:

Section 1491 3

Section 1255(1) 2

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Memphis Transit Company, your petitioner, respectfully prays that a Writ of Certiorari be issued to review the order and judgment of the United States Court of Claims dismissing its petition to that Court. A certified transcript of the record is furnished herewith in accordance with Rule 21(1) of the Rules of this Court.

Opinion Below

The opinion and findings of the fact of the United States Court of Claims in petitioner's case are printed in Appendix A hereto, *infra*, pp. 1a-31a, and are reported at 297 F. 2d 542.

Jurisdiction

The order and judgment of the United States Court of Claims was entered on December 6, 1961 (*infra*, Appendix

A hereto, p. 8a). The Court entertained petitioner's timely motion for a rehearing and overruled the same on March 7, 1962. The jurisdiction of this Court is invoked under the provisions of Title 28, United States Code, Section 1255(1).

Questions Presented

(1) Whether the petitioner issued 25,000 shares of its common stock on December 18, 1905 in part consideration for properties acquired from the Memphis Street Railway Extension Company on that date?[1]

(2) Whether in determining petitioner's equity invested capital applicable to the year 1944 effect should be given, in computing earnings and profits at the beginning of said year, to the final tax liability for the taxable period April 1, 1943 to December 31, 1943 after giving due effect to the reduction of the amount of such liability arising from the application of carrybacks of net operating losses and unused excess profits credits applicable in computing said final tax liability?

(3) Whether in determining petitioner's equity invested capital applicable to the year 1944 effect should be given, in computing the unused excess profits credit carrybacks arising in respect of calendar years 1945 and 1946 applicable in computing the excess profits credit for the year 1944, to the final tax liability for the year 1944 after giving

[1] The parties stipulated in the Court below the methods of determining the petitioner's additional abandonment losses for 1945, 1946 and 1947 and the addition to its equity invested capital for the taxable period April 1, 1943 to December 31, 1943, 1944, 1945 and 1946 in the event that the Court below found that the 25,000 shares of petitioner's common stock were issued in part consideration for Memphis Street Railway Extension Company's properties and found a fair market value for such stock.

due effect to the reduction of the amount of such liability arising from the application of carrybacks of net operating losses and unused excess profits credits applicable in computing said final tax liability?

Statutes Involved

The statutes involved in this case are sections of the Internal Revenue Code of 1939 as applicable to the years 1943 through 1947. The specific sections of the Internal Revenue Code of 1939 which are controlling in this case are Sections 23(f), 23(l), 113(a), 718(a). These sections of the Internal Revenue Code of 1939, together with Treasury regulations, are set forth in pertinent part in Appendix C hereto, *infra*, pp. 1c-5c.

Statement of the Case

Memphis Transit Company, petitioner herein, brought an action against the United States in the United States Court of Claims to recover a part of the United States income and excess profits taxes paid by it for the taxable period April 1, 1943 to December 31, 1943 (hereinafter sometimes referred to as the 1943 period) and for the calendar years 1944 and 1947 in the respective amounts of $333,627.58, $463,481.36 and $52,368.75. The jurisdiction of the United States Court of Claims in this case is based on Title 28, United States Code, Section 1491 which grants jurisdiction to that Court to render judgment upon any claim against the United States founded upon any Act of Congress.

Essentially, the facts of this case are that petitioner, Memphis Transit Company (the name of which corporation was The Memphis Street Railway Company prior to March 21, 1958), was engaged primarily in the operation

of an electric street railway system in the City of Memphis prior to 1945. The electric street railway system was abandoned in 1945, 1946 and 1947, and thereafter petitioner engaged in the operation of a motor bus and trackless trolley system. Petitioner maintains its books and files its tax returns on the accrual and calendar year basis.

In 1904, petitioner was engaged in operating a street railway system in the City of Memphis. In February of that year, there was incorporated The Memphis Street Railway Extension Company (hereinafter sometimes referred to as Extension Company). This corporation issued 500 shares of stock, of which 496 were issued to W. S. McCrea who was a secretary and director of petitioner and the remaining 4 shares were issued to other individuals. At that time petitioner had outstanding 5,000 shares of common stock, of which 3,331 shares were owned by C. K. G. Billings, 1,666 shares were owned by Frank G. Jones, and the remaining 3 were owned by other individuals.

On or about February 22, 1905, Extension Company received a franchise from the Legislative Council of the City of Memphis to construct, operate and maintain a street railway system over certain streets in the City of Memphis, which lines would connect to the lines owned and operated by petitioner. Acting under the authority of said franchise, Extension Company entered into an engineering contract with Ford, Bacon & Davis, as a result of which 14.9 miles of lines were constructed prior to December 18, 1905, consisting of 27 extensions to petitioner's system. During this period, Extension Company also acquired cars, powerhouse equipment, carhouses, buildings, fixtures and miscellaneous equipment required for the operation of the railway lines constructed by it. Its construction

costs as of December 18, 1905 as shown by its books of account totaled $700,000, but said books did not contain any recorded asset account or value for Extension Company's franchise to construct, operate and maintain street railway lines in the City of Memphis, or for other intangibles.

On March 4, 1905, W. S. McCrea assigned his 496 shares of Extension Company to Ford, Bacon & Davis. As a consequence of subsequent transfers, on December 18, 1905 Extension Company's stock was held as follows: Isidore Newman & Sons—495 shares; five individuals—1 share each.

On March 4, 1905, all of the outstanding shares of petitioner's capital stock were assigned to Isidore Newman & Sons, Trustees. As a consequence of subsequent transfers, on December 18, 1905 the stock of petitioner was held as follows: Isidore Newman & Sons, Trustees—4,989 shares; eleven individuals—1 share each.

Extension Company entered into a contract with petitioner on December 18, 1905, under which it agreed to sell to petitioner "all its property, real, personal and mixed, and its franchises, immunities, rights and privileges, with the exception of its franchise or right to be a corporation." The transfer of these properties was to be free and clear of all indebtedness except for the outstanding liability of Extension Company to pay $650,000 of its promissory notes held by Isidore Newman & Sons which the Extension Company agreed to pay upon receipt of the purchase price from petitioner. The purchase price agreed upon was 25,000 shares of petitioner's common stock in the aggregate amount of $2,500,000 par value and $700,000 principal amount of petitioner's Consolidated Mortgage 5 Percent Gold Bonds. The contract was carried out according to its terms.

Before entering into the contract referred to above, petitioner had no outstanding preferred stock and only 5,000 shares of common stock. Petitioner's stockholders, however, on December 18, 1905, authorized the issuance of 25,000 shares of preferred stock and approved an exchange pursuant to which the old common stock was retired and the holders thereof were issued 25,000 shares of the new preferred stock having a par value of $100 per share. At the same time the petitioner's stockholders approved the issuance of 25,000 shares of the new $100 par value common stock to the Extension Company together with the $700,000 of petitioner's Consolidated Mortgage 5 Percent Gold Bonds in exchange for Extension Company's assets under the Contract as hereinabove described.

During the years 1945, 1946 and 1947, the petitioner abandoned its street railway operations (including that part of its operations attributable to the properties acquired on December 18, 1905) and substituted therefor motor bus and trackless trolley operations. Petitioner over said three year period was allowed a loss deduction by the Internal Revenue Service in respect of the obsolescence and abandonment of the street railway properties but the cost basis of all of the petitioner's properties, applicable in part in the determination of such loss, as established by the Internal Revenue Service, did not include any cost in respect to the 25,000 shares of petitioner's common stock issued as part consideration for the Extension Company's properties acquired by petitioner on December 18, 1905.

Further, in computing the petitioner's excess profits tax liability for the taxable 1943 period and the year 1944 by application of an excess profits credit determined in accordance with the invested capital method as provided in Section 718 of the 1939 Code, the portion of petitioner's

equity invested capital referable to capital stock, as established by the Internal Revenue Service for the 1943 period, and the years 1944, 1945 and 1946 did not include any value for the said 25,000 shares of common stock issued on December 18, 1905.

Claims for refund were duly filed by the petitioner with the Commissioner of Internal Revenue for the taxable period April 1943 to December 31, 1943[2] and for the calendar years 1944 and 1947 claiming additional abondonment losses applicable to the years 1945, 1946[3] and 1947 with respect to the property acquired in exchange for the 25,000 shares of common stock issued for the Extension Company properties on the basis of a fair market value for said stock of $73.50 per share; claiming an increase by the same amount in its equity invested capital for purposes of computing its excess profits tax liability for the 1943 period and the calendar year 1944; and claiming petitioner's right, for the purpose of determining its excess profits tax credit for the year 1944 including excess profits tax credit carrybacks and carryovers to such year, to subtract from earnings and profits prior to reduction thereof for federal income and excess profits taxes only the amount of such taxes computed after giving due effect to net operating loss and excess profits tax credit carrybacks.

Petitioner's contentions, as set forth in the aforesaid claims, were formally rejected by the Commissioner of

[2] For the period January 1, 1943 to March 31, 1943 petitioner's return was included in the consolidated return filed by National Power and Light Company and subsidiary companies. No issue is presented here as to such return.

[3] No recoveries were claimed by petitioner for 1945 and 1946 because no tax was paid for these years. However, the additional abandonment losses, if allowed, have an effect on the net operating loss carrybacks and unused excess profits carrybacks to the 1943 period and the year 1944 if petitioner prevails with respect to issues (2) and (3) set forth in the Statement of Questions.

Internal Revenue and the action was duly commenced in the Court below.

On December 6, 1961 the Court of Claims found that the 25,000 shares of common stock issued on December 18, 1905 had a fair market value of $70 per share but that the stock was not issued in part consideration for Extension Company properties and therefore the petitioner was not entitled to additional abandonment losses for 1945, 1946 and 1947, nor was it entitled to an increase in its equity invested capital for purposes of computing its excess profits tax liability for the 1943 period and the calendar year 1944. The Court below also rejected the petitioner's contentions relating to the computation of its accumulated earnings and profits for purposes of calculating excess profits tax credits for the 1943 period and the calendar year 1944.

The Court below entertained the petitioner's motion for a rehearing, duly filed, which it overruled on March 7, 1961.

REASONS FOR GRANTING THE WRIT

I

The decision of the United States Court of Claims below pertaining to the issue of whether in fact the petitioner issued 25,000 shares of its common stock in the aggregate amount of $2,500,000 par value in part consideration for properties acquired from the Memphis Street Railway Extension Company on December 18, 1905 has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

II

The decision of the Court below with respect to the issue of the method of determining accumulated earnings and profits for the purpose of calculating the petitioner's excess profits tax credits and therefore its excess profits tax liability for the periods April 1, 1943 to December 31, 1943 and for 1944 is, in principle, in conflict with decisions in the United States Courts of Appeals for the Sixth Circuit and the Ninth Circuit.

These reasons will be fully explained below.

I

The decision of the United States Court of Claims below pertaining to the issue of whether in fact the petitioner issued 25,000 shares of its common stock in the aggregate amount of $2,500,000 par value in part consideration for properties acquired from the Memphis Street Railway Extension Company on December 18, 1905 has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

An issue for decision in this case as to whether the petitioner is entitled to additional abandonment losses for the years 1945, 1946 and 1947, and as to whether the petitioner's equity invested capital should be increased for the 1943 period and for the years 1944, 1945 and 1946 in order to ascertain the petitioner's excess profits tax liability for the 1943 period and for the calendar year 1944, depends on whether in fact the petitioner issued 25,000 shares of its common stock on December 18, 1905 in part consideration for properties acquired by petitioner

from the Extension Company, and the fair market value of such stock.

The evidence in respect to this issue presented to the Court below was contained in a stipulation of facts (*infra*, Appendix B, pp. 1b-24b). The Court found from this evidence as presented that the 25,000 shares of common stock issued by the petitioner to Extension Company on December 18, 1905 in exchange for the properties of the latter company had a fair market value of $70 per share, but that said stock was not in fact issued as part of the consideration for the properties.

In finding that the 25,000 shares of common stock were not part of the consideration for the properties, the Court below committed clear and exceptional error in its disregard of the evidence as presented, and its departure from the accepted and usual course of a judicial proceeding calls for the exercise of this Court's power of supervision. While it is recognized by the petitioner that this Court will not ordinarily grant certiorari to review the judgment of a lower court based solely on questions of fact, it is equally clear that this Court will grant a writ where the record before the lower court presented clear and overwhelming proof of facts contrary to the lower court's findings of fact; *cf. National Labor Relations Board* v. *Waterman Steamship Corporation*, 309 U. S. 206 (1940). It is respectfully submitted that the findings of the Court below are contrary to the proof of the facts in this case.

The essence of the decision of the Court below lies in its ultimate findings of fact at Paragraphs 26, 28 and 30 (*infra*, Appendix A, pp. 27a, 28a, 30a), which are in pertinent part:

> "26. In finding 14 it was determined that the fair market value of plaintiff's new common stock

authorized December 18, 1905, was reasonably $70 per share. There is no satisfactory evidence that the 25,000 shares of plaintiff's common stock issued to the Extension Company were truly a part of the consideration for the assets acquired by plaintiff through an indenture and conveyance by the Extension Company to the plaintiff dated December 18, 1905.

The true stockowners of the plaintiff company and the Extension Company at December 18, 1905, when the transactions occurred, are not determinable from the evidence. It is reasonable to conclude that they were identical (see findings 10 and 11). When the Extension Company was organized on February 21, 1905, it issued 500 shares of capital stock, of which 496 shares were issued to W. S. McCrea, plaintiff's secretary and a director, obviously the 'straw man' or nonentity.

* * * * *

"28. * * * Considering all of the evidence in this case, it is reasonable to conclude that the stockholders of the Extension Company and the plaintiff were identical and that 25,000 shares of plaintiff's common stock were indirectly paid to plaintiff's own stockholders.

* * * * *

"30. The Extension Company had not fully developed its franchise and had never operated any part of it. There is no evidence that the Extension Company had ever intended to operate its franchise or that it could have been operated profitably, except as an adjunct of the plaintiff's system.

It is reasonable to conclude that the $700,000 of 5 percent bonds issued by the plaintiff as of December 18, 1905, represented the fair and reasonable net value of all assets acquired by the plaintiff from the Extension Company and that no consideration

can be reasonably attributable to the 25,000 shares of its common stock as a part of the consideration of such assets, as set forth in the proposed agreement of December 18, 1905, by the Extension Company * * *."

The above findings by the Court below are inconsistent with and unsupported by the facts contained in the stipulation. Paragraph 12 of said stipulation states (*infra*, Appendix B, p. 7b):

> "12. In an offer dated December 18, 1905 set forth in the minutes of a meeting of stockholders of Extension Company held on the same date, a true copy of said minutes being hereto attached as Exhibit E, *Extension Company offered to convey to plaintiff 'all its property, real, personal and mixed, and its franchises, immunities, rights and privileges, with the exception of its franchises or right to be a corporation.'* These properties are described in detail at Exhibit E-1, which is the minutes of an adjourned special meeting of the board of directors of Extension Company held at 6:00 P.M. on December 18, 1905. The transfer of these properties was to be free and clear of all indebtedness except for the outstanding liability of Extension Company to pay off $650,000 of its promissory notes which Extension Company agreed to pay upon receipt of the purchase price. *In return, plaintiff was to pay a purchase price of 25,000 shares of plaintiff's common capital stock in the aggregate amount of $2,500,000 par value and $700,000 principal amount of plaintiff's Consolidated Mortgage 5% Gold Bonds.* Extension Company's offer was approved by plaintiff's stockholders at an adjourned special meeting of said stockholders held December 18, 1905 and was accepted by plaintiff's officers under authority of the directors of plaintiff at a meeting of plaintiff's directors held December 18, 1905. *Said agreement was carried out according to its*

terms as shown by minutes of an adjourned special meeting of the board of directors of Extension Company held at 6:00 P.M. December 18, 1905; see Exhibit E-1." (Emphasis supplied.)

The above stipulation positively establishes the essential fact that the 25,000 shares of the petitioner's (referred to as 'plaintiff' in the above quoted stipulation) common stock were issued as a part of an undivided consideration for all of the Extension Company's properties including that Company's franchises, immunities, rights and privileges (other than its corporate franchise). In so finding that the $700,000 of the petitioner's bonds were the sole consideration for the aforesaid properties of the Extension Company, the Court below committed clear and exceptional error. Not only did the Court below find contrary to the facts as established by the evidence in the record, but its finding that petitioner's bonds were the sole consideration for the subject properties goes beyond the four corners of the evidence presented and constitutes a violation of its judicial function.

It is respectfully submitted that the United States Court of Claims' finding that petitioner paid only $700,000 of its bonds for the properties purchased from Extension Company where petitioner and respondent had stipulated that petitioner paid a purchase price consisting not only of the $700,000 of petitioner's bonds but also of 25,000 shares of petitioner's common stock is a clear departure from the accepted and usual course of a judicial proceeding which calls for an exercise of this Court's power of supervision.

II

The decision of the Court below with respect to the issue of the method of determining accumulated earnings and profits for the purpose of calculating the petitioner's excess profits tax credits and therefore its excess profits tax liability for the periods April 1, 1943 to December 31, 1943 and for the year 1944 is, in principle, in conflict with decisions in the United States Court of Appeals for the Sixth Circuit and the Ninth Circuit.

The decision of the Court below denied the petitioner the right for the purpose of calculating excess profits tax credits to compute its earnings and profits as of the close of the 1943 taxable period and the year 1944 so as to reflect the income and excess profits tax liabilities for these years after giving due effect to the reduction of such tax liabilities by application of the net operating loss and unused excess profits credit carrybacks from the years 1945 and 1946.

Petitioner requested the United States Court of Claims to accept the view that accumulated earnings and profits should reflect a corporation's "true financial status" as of the end of the taxable year for the purpose of computing the excess profits tax credit for the subsequent taxable year and therefore should be computed by subtracting the corporation's ultimate tax liability for the year regardless of whether such tax liability was determinable at the end of the year or depended on events occurring in subsequent years which affected such tax liability such as carrybacks of net operating losses and unused excess profits tax credits from subsequent years. Petitioner relied on decisions by two United States Courts of Appeals that earnings and profits should reflect "true financial status" and therefore the ultimate proper tax liability for the year even though such liability could not have been accrued as

of the end of the year for the purpose of ascertaining the effect of such liability upon net income and depended for its determination on events occurring in subsequent years.

> *F. W. Drybrough et al. v. Commissioner of Internal Revenue*, 238 F. 2d 735 (6th Cir. 1956); *Pacific Affiliate, Inc. v. Commissioner of Internal Revenue*, 224 F. 2d 578 (9th Cir. 1955), cert. den. 350 U. S. 976 (1956).

In *F. W. Drybrough et al. v. Commissioner of Internal Revenue, supra*, the Commissioner had asserted and the Tax Court upheld deficiencies against a corporation for failure to report receipt of diverted funds in its income and excess profits tax returns for the years 1942 through 1946. The aforesaid funds of the corporation were secretly diverted over the five year period by individuals who were the majority stockholders and in dominant control of the corporation during the years in question. The Commissioner also determined that the entire amount of the diverted funds constituted taxable dividends to the individual stockholders (the appellants in the subject case) and accordingly asserted deficiencies and civil fraud penalties against the stockholders individually which the Tax Court also sustained.

The Court of Appeals held that the diverted funds were only taxable as dividends to the stockholders to the extent that the corporation had earnings and profits for the years in which the funds were withdrawn. On the earnings and profits issue, the Court held that the corporation's ultimate tax liabilities for the years 1942 through 1946 as set forth in the deficiencies found by the Tax Court in 1955 must be deducted in computing earnings and profits for the

years 1942 through 1946 even though such deficiencies were contested until 1955 and the liability therefor depended on an event subsequent to the years 1942 through 1946 *i.e.* a determination by the Tax Court long after the close of such years. Therefore, the Court of Appeals for the Sixth Circuit held that earnings and profits must reflect a corporation's true financial status even though such true financial status may be dependent on events that do not occur until after the close of the taxable year.

In *Pacific Affiliate, Inc.* v. *Commissioner of Internal Revenue, supra,* the Court of Appeals for the Ninth Circuit held that for the purpose of computing invested capital as of the end of 1943, the computation of earnings and profits should be made by subtracting an amount of federal income tax liability that was disputed as of the end of 1943 and not ultimately found as a liability by the Tax Court until 1952. Here again, a United States Court of Appeals held that earnings and profits must reflect true financial status as of the end of the year even though such determination turned on an event long after the end of the year, *i.e.* a decision by the Tax Court.

It is respectfully submitted that the decision of the Court below holding that net operating loss and unused excess profits credit carrybacks do not affect federal tax liability of the year to which such carrybacks are carried for the purpose of computing accumulated earnings and profits at the end of such year conflicts with the principles adopted by the United States Courts of Appeals for the Sixth Circuit and for the Ninth Circuit in the above decisions.

In reaching its conclusion in petitioner's case, the Court below relied on the decision of this Court in *Lewyt Corporation* v. *Commissioner of Internal Revenue,* 349 U. S. 237 (1955) to the effect that, for the purpose of

calculating the net operating loss *deduction from income* under Section 122(d)(6) of the Internal Revenue Code of 1939, excess profits tax liability for a taxable year must be computed without giving effect to a net operating loss carryback. The United States Court of Appeals for the Ninth Circuit in *Pacific Affiliate, Inc.* v. *Commissioner of Internal Revenue, supra*, distinguished the decision in *Lewyt Corporation* v. *Commissioner of Internal Revenue, supra*, on the ground that it concerned the computation of income and not the computation of earnings and profits where the doctrine of true financial status applied. The Court of Appeals said:

> "*Lewyt, supra*, in no respect challenges the distinction made by the Tax Court. In *Lewyt* the Supreme Court affirmed the Court of Appeals so far as it followed the rule of *Dixie Pine Co.* v. *Commissioner, supra*, and *Security Mills Co.* v. *Commissioner, supra*. The primary issue involved in the tax litigation there was the interpretation and application of 26 U.S.C. §122(d)(6) in computing net operating loss deductions from income. The opinion of the Supreme Court in reversing in part the decision of the lower court as well as the dissenting opinion of Justice Frankfurter clearly indicates that the decision should be narrowly confined to an interpretation of the statutory *language* of said section 122(d)(6) of the Internal Revenue Code. We are of the opinion that the decision does not lessen the validity of the distinction made by the Tax Court in not applying the rule of *Dixie Pine Co.* and *Security Mills Co., supra*, when dealing with the accrual of federal income and excess profits taxes called for by Treasury Regulation 112, Section 35.718-2(a)." (224 F.2d 578, 580.)

From the aforesaid, it is clear that the decision of the United States Court of Claims also conflicts in principle with the decision of the United States Court of Appeals for the Ninth Circuit in interpreting the meaning of the Court's decision in *Lewyt Corporation* v. *Commissioner of Internal Revenue, supra.*

Therefore, it is submitted that this petition should be granted for the reason that the decision of the United States Court of Claims conflicts in principle with the decisions of the United States Court of Appeals for the Sixth Circuit and the United States Court of Appeals for the Ninth Circuit.

Conclusion

The writ of certiorari to the United States Court of Claims should be granted for the following reasons:

(1) That the decision of that Court insofar as the finding that the petitioner did not in fact issue 25,000 shares of its common stock as part consideration for the properties acquired from the Memphis Street Railway Extension Company on December 18, 1905 has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

(2) That the decision of that Court in respect to its rejection of the petitioner's method of determining accumulated earnings and profits for the purpose of calculating its excess profits tax credits in determining its excess profits tax liability is, in principle, in conflict with

the decisions of the Courts of Appeals for the Sixth Circuit and the Ninth Circuit.

Respectfully submitted,

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